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March 17, 2004

IN REPLY REFER
TO FILE NO: 933-0052

FINAL REPORT

Amir Neshat, DDS
President, CEO
Liberty Dental Plan of California, Inc.
3636 Birch Street, Suite 250
Newport Beach, CA 92660

RE: ROUTINE EXAMINATION

Dear Mr. Neshat:

Enclosed is the final report of a routine examination of the fiscal and administrative affairs of Liberty Dental Plan of California, Inc. ("Plan") conducted by the Department of Managed Health Care (the "Department") pursuant to Section 1382 of the Knox-Keene Health Care Service Plan Act of 1975 ("Act").¹ The Department engaged the services of PMPM Consulting Group, Inc. (PMPM) to conduct the examination.

The Department issued a Preliminary Report to the Plan on October 16, 2003. The Report requested the Plan to comment and state the actions taken to implement the noted recommendations. The Plan also should have included the management position responsible for overseeing the implemented recommendations; a description of the monitoring system implemented to ensure ongoing compliance with the recommendation, and the date the recommendation has been implemented.

The Department received the Plan's response to the preliminary report on December 3, 2003. This Final Report includes a description of the compliance efforts included in the Plan's response, in accordance with Section 1382(c).

The Plan's response did not fully address the deficiencies cited or the corrective actions required. The

¹ References throughout this report to "Section" are to sections of the Knox-Keene Health Care Service Plan Act of 1975, California Health and Safety Code Section 1340, *et seq.* References to "Rule" are to the regulations promulgated pursuant to the Knox-Keene Health Care Service Plan Act, found at Chapter 1 of Division 1 of Title 28, California Code of Regulations, beginning with Section 1300.43, and transferred to the Department of Managed Care pursuant to Health and Safety Code Section 1341.14.

Amir Neshat
Liberty Dental Plan of California, Inc.
March 17, 2004

Plan is requested to state the actions taken to implement the noted recommendations. The Plan is also to include the management position responsible for overseeing the implemented recommendations; a description of the monitoring system implemented to ensure ongoing compliance with the recommendation, and the date the recommendation has been implemented. The Plan response is due within 10 days of receiving this report.

Section 1382(d) states "If requested in writing by the plan, the commissioner shall append the plan's response to the final report issued pursuant to subdivision (c). The plan may modify its response or statement at any time and provide modified copies to the department for public distribution not later than 10 days from the date of notification from the department that the final report will be made available to the public. The addendum to the response or statement shall also be made available to the public."

Please indicate within ten (10) days whether the Plan requests the Department to append its response to the final report. If so, please indicate which portions of the Plan's response shall be appended, and provide copies of those portions of the Plan's response exclusive of information held confidential pursuant to Section 1382(c), no later than ten (10) days from the date of the Plan's receipt of this letter.

If the Plan requests the Department to append a brief statement summarizing the Plan's response to the report or wishes to modify any information provided to the Department in its October 16, 2003 response, please provide the documentation no later than ten (10) days from the date of the Plan's receipt of this letter.

The Department will make the attached Final Report available to the public in ten (10) days from the Plan's receipt of this letter.

If you have any questions regarding this report, please call.

Mark Wright
Chief
Division of Financial Oversight
(916) 324-9026

cc: Richard Martin, Supervising Examiner
Kelvin Gee, Examiner
Mike Punja, Staff Counsel

REPORT OF ROUTINE EXAMINATION

Liberty Dental Plan of California, Inc.

For the period ended April 30, 2003

File Number: 933-0052

Date of Report: March 17, 2004

Contractor: PMPM Consulting Group, Inc.

**LIBERTY DENTAL PLAN OF CALIFORNIA, INC.
BACKGROUND INFORMATION**

Date Plan Licensed:	Liberty Dental Plan of California, Inc acquired all the assets of Preferred Health Plans, Inc. d.b.a. Preferred Dental Plan on December 27, 2001. Preferred Health Plans, Inc. was licensed August 3, 1978.
Organizational Structure:	Liberty Dental Plan of California operates in California and provides managed dental services on a contractual basis. Members pay the Plan a monthly premium with additional scheduled co-payments payable to network providers for services rendered.
Type of Plan:	Specialized.
Provider Network:	The Plan has contracted with dentists and specialists that are pre-screened to meet standards set forth by Liberty Dental Plan's active quality management program.
Plan Enrollment:	A total of 13,314 enrollees were reported for the month ended January 31, 2004.
Service Area:	The Plan contracts with dentist throughout California.

REPORT OF A ROUTINE EXAMINATION OF LIBERTY DENTAL PLAN OF CALIFORNIA, INC

This is the Final Report of a routine examination of the fiscal and administrative affairs of the Liberty Dental Plan of California, Inc. Health Plans of California, Inc. (the “Plan”), conducted by PMPM Consulting Group, Inc. (PMPM) on behalf of the Department of Managed Health Care (the “Department”) pursuant to Section 1382(b) of the Knox-Keene Health Care Plan Act of 1975.¹

We examined the financial report filed with the Department for the period ended April 30, 2003, as well as other selected accounting records and controls related to the Plan’s various fiscal and administrative transactions. Our findings are presented in this report as follows:

OVERALL ASSESSMENT:

Although our examination identified a number of operational and compliance issues that need to be addressed immediately, on an overall basis, it appears that the Plan has initiated appropriate actions which will enhance the Plan’s opportunities to meet or exceed its enrollment targets and ultimately reach breakeven. Key Plan managers have significant background and experience in the prepaid dental business and appear capable of providing needed leadership to the company. One notable exception is in the accounting department where the absence of qualified financial leadership must be resolved immediately.

ORGANIZATION STRUCTURE:

During the examination it was determined that the Plan maintained a continuing business relationship with Newport Coast Dental, a shell corporation owned and controlled by Dr. Amir Neshat, who is also the sole owner of Plan. The continuing business relationship was evidenced by the following business activities:

- ❑ Periodic transfers of cash between organizations
- ❑ Certain Plan employees were paid by Newport Coast Dental under separate agreements

Based on the aforementioned business activities and common ownership of both organizations, we have determined that an affiliate relationship exists between the Plan and Newport Coast Dental.

Recommendation: Until such time as the relationship between the two organizations is changed, and an affiliate relationship no longer exists, the financial statements of both organizations must be reported to DMHC on a consolidated basis.

DMHC is also concerned with the finding that two Plan employees (Dental Director Richard Hague, and Regional Manager, Anabel Collings) continue to receive their compensation through Newport Coast

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Dental under separate employment agreements. Until March 31, 2003, Regional Manager, Machelie Madden was also paid under a similar arrangement. As these employees are solely dedicated to the Plan there is no rational basis for the aforementioned employees to be compensated for their services through the affiliate and such contracts should be assigned to the Plan or terminated and new agreements negotiated.

Recommendations:

- ❑ **Salary and benefit expenses associated with these employees shall be considered Plan expenses for financial statement and compliance purposes.**
- ❑ **Plan shall confirm within thirty (30) calendar days of the date of this letter, that the agreements between Dr. Hague, Ms. Collings and Newport Coast dental have been assigned to or re-negotiated with Plan.**
- ❑ **Plan shall cease and desist from making any further transfers to/from Newport Coast Dental unless there is a bona fide business purpose (i.e. contracted participating provider) for such activity.**

Plan's Response:

The Plan stated all relationships between the two sister corporations were immediately terminated in July of 2003 as soon as they were disclosed by PMPM during the routine examination. Newport Coast Dental, Inc. acquired four dental offices from Preferred Dental Plan in May of 2001. In October of 2002, these practices were sold. There have been no transactions or activities between the two corporations and there will be none in the future.

All salaries and expenses associated with the employees: Dr. Hague and Ms. Collings, were rolled in as Plan expenses immediately in July per PMPM's recommendation. Dr. Hague and Ms. Collings contracts were also assigned to the Plan effective immediately upon PMPM's recommendation back in July.

Based on the above, the Plan states it will continue to submit financial statements on a non-consolidated basis in compliance with the Knox-Keene regulations.

The Plan is required to submit evidence that the contracts for Dr. Hague and Ms. Collings have been assigned to the Plan.

ADMINISTRATIVE CAPACITY:

Analysis of the Plan's administrative staffing composition as of April 30 revealed the following staffing deficiencies:

Accounting Department:

- ❑ The Plan does not have an active Chief Financial Officer (CFO) on staff. Although Plan records indicate the CFO is Mr. Mike Ghaffari, at no time was Mr. Ghaffari present during the examination, nor was there any evidence of Mr. Ghaffari's direct involvement in the day-to-day operation of the Plan. It would appear that Mr. Ghaffari's position is supervisory at best and certainly not adequate to meet the day-to-day financial needs of the Plan.
- ❑ The Plan also did not have an employed accountant on staff and was essentially functioning with a part-time account clerk (who was/is in the process of relocating out of state).

The condition of the books and records was deemed to be sub-standard. The lack of adequate staffing, combined with the lack of internal policies and procedures and insufficient supervision and control, is cause for significant concern. The Plan must act quickly to secure qualified accounting staff to meet the ongoing needs of the accounting department.

Recommendation: Plan shall immediately recruit appropriate accounting staff, including a CFO, within 30 calendar days of the date of this letter.

Plan's Response:

Plan hired Mr. Joseph Hughes, with over 20 years of experience as CFO/Controller, as of November 1, 2003. In addition to Mr. Hughes, Mrs. Minerva Juarez, with four years experience as an accounting assistant, has been hired to assist Mr. Hughes.

The Plan is required to submit evidence that the hiring of Mr. Hughes, CFO has been filed with the Department in accordance with Section 1352(c) and Rule 1300.52.2 that requires a plan to file, within 5 days, an amendment to its application when there are any changes in key personnel of the plan. In addition, the Plan must indicate the allocated time Mr. Hughes will spend on Plan business.

FINANCIAL SOLVENCY:

Tangible Net Equity (TNE) – Rule 1300.76

The Plan's financial report for the month ending April 30, 2003 reported excess TNE of \$111,614. However, several journal entries were required at the time of the examination to properly state the balance sheet and income statement. After all adjusting entries were made, the Plan's TNE, on a non-consolidated basis was determined to be \$151,614 (\$101,614 in excess of the \$50,000 minimum TNE requirement) as of April 30, 2003. On a consolidated basis, the Plan's combined TNE was determined to be \$771,281 (\$721,281 in excess of the \$50,000 minimum TNE requirement). A copy of the Plan's financial statements can be obtained at the Department's website by typing the link <http://wpsso.dmhc.ca.gov/fe/search.asp> and selecting the Plan's name on the first drop down menu.

General and Administrative Costs (G&A) – Rule 1300.78

For the 10-months ending April 30, 2003, Plan's general and administrative costs were \$550,792 (excluding \$50,196 of eligible expenses recorded on the books of Newport Coast Dental). Total Plan revenues for the 10-month period were \$470,430. Inclusive of all eligible expenses (\$600,988), general and administrative costs averaged 128% of revenues for the period. It is important to note that Dr.

Neshat continues to serve as CEO without any form of compensation for his services and Hugh Hazlewood and Marsha Hazlewood, seasoned healthcare executives, have effected an agreement with the Plan that compensates these individuals with future revenues on new business brought to the Plan. If the value of these arrangements were fully realized the ratio of General and administrative costs would be considerably greater.

Health care expenses for the 10-month period ending April 30, 2003 averaged 23.4% of revenues, which means that general and administrative expenses will need to remain at or below 76.6% of revenues for the Plan to reach and sustain breakeven. This represents at least a 67% reduction in general and administrative costs over the next several months.

***Recommendation:* Although enrollment gains and increased revenues will significantly reduce the general and administrative percentage, the Plan shall submit documentation that supports the identification and implementation of other cost reduction strategies in order to reach breakeven as soon as possible.**

Plan's Response:

The Plan stated it has eliminated three positions and incorporated those responsibilities into other departments. The Plan eliminated the "Compliance Officer" position in August 2003 and duties were distributed amongst the appropriate departments, the "Sales/Small Broker Relations" (Proposal Processing) position was eliminated in September and the duties were transferred to Director of Operations. The "Financial Reporter" position was eliminated and the duties were transferred to the CFO. The Interim CFO position, previously paid on an hourly basis, was eliminated in November and the duties were transferred to the newly hired CFO, Mr. Hughes.

The Plan is required to submit the projected cost savings associated with the administrative changes as described in its response for the next twelve months.

Adequacy of Working Capital – Rule 1375.1:

Total current assets as of April 30, 2003 were \$47,909 and current liabilities (including claims incurred but not reported) were \$64,624 (.74:1). As a result, there was insufficient working capital to meet anticipated obligations in the normal course of business. It is expected that current assets (cash and other assets that can be converted to cash in one accounting cycle) will continue to remain at or below present levels unless additional revenues are generated and/or cash infusions made to improve the Plan's operating cash flows in the next few months.

***Recommendation:* The Plan must submit documentation that supports its ability to meet or exceed a minimally acceptable working capital ratio of 1:1 (current assets are greater than or equal to current liabilities) within 30 calendar days of the date of this letter.**

Plan's Response:

The Plan indicated that it's President, Amir Neshat, D.D.S. has pledged additional working capital funds in the amount of \$50,000 which places the plan in compliance with the Department's requirements. The Plan states that current assets are now at a level of 1.52:1 which exceeds the stated requirement.

The financial statements submitted to the Department do not indicate that \$50,000 in capital was ever contributed to the Plan. However, there was a capital infusion reported in September 2003 of \$26,000, but the Plan's working capital for that period was only at .72:1 (current assets reported \$142,217, current liabilities reported 198,346). As of the month ended January 31, 2004 the Plan's reported working capital remains below a ratio of 1:1. The Plan reported current assets of \$164,664 to current liabilities of \$236,164, resulting in a working capital ratio of only .70:1.

The Plan's history of operations demonstrates the Plan is not self-sustaining. In addition, the Plan has been unable to meet past projections that have been provided to the Department. In April 2003, the Plan filed projections showing a total profit of \$14,915 for the period August 2003 through January 2004. For that same period, the Plan reports actual net losses totaling <\$103,587>.

The Plan is required to submit a detailed Corrective Action Plan ("CAP"). The CAP must include detailed projections, supported by all applicable assumptions, for the next twelve months and address any capital funding requirements necessary for the Plan to comply with Sections 1375, 1376 and Rules 1300.75.1 and 1300.76.

In September 2003, the Plan provided "Forecast for Twelve Months Ending June 30, 2004 – Management Discussion" via electronic mail to PMPM and Richard Martin. The CAP to be submitted in response to this report must include an amended and updated "Management Discussion" that supports the required projections for the next twelve months and outline management's initiatives to improve operations and demonstrate the Plan's ability to sustain financial soundness through its own operations.

The Plan must also provide the Department with a written guarantee of operations from Dr. Neshat that provides the Plan with access to sufficient capital in order to maintain financial viability and minimum TNE requirements set forth in Sections 1375, 1376 and Rules 1300.75.1 and 1300.76. In addition, the Plan must demonstrate and provide evidence that Dr. Neshat has the ability to continue funding the Plan as needed.

Solvency Protection/Reimbursement (Adequate Insurance Coverage) – Rule 1300.77:

Analysis of Plan insurance coverage revealed the following exceptions:

General Liability Coverage:

The Plan's general liability policy has an insurable limit of \$1 million per occurrence and \$1 million in the aggregate. However, the Plan's lease agreement requires a \$2.0M insurable limit. As a result, the Plan's coverage does not comply with its current lease obligation.

The Plan's general liability policy also covers another unrelated business address (which we understand to be Mrs. Neshat's personal business address). Therefore, if an unforeseen loss were to occur at both locations in the same coverage period, the Plan may or may not have sufficient coverage to cover all losses.

Under the general liability policy, coverage for business assets was limited to \$100,000. Based on information obtained from the Plan's accounting records, the net book value of recorded furniture, fixtures, equipment, computer hardware, and software assets was \$116,000 as of April 30. A Plan inventory of fixed assets conducted during the examination suggests that the Plan's fixed assets are actually much higher -- in the range of \$264,000. For this reason, the Plan's business assets appear to be underinsured and coverage should be increased accordingly.

RECOMMENDATION: The Plan shall increase its general liability coverage from \$1.0M to \$2.0M pursuant to its lease agreement, increase coverage of its business assets to \$275,000 and delete Mrs. Neshat's business address from the Plan's policy within 30-days of the date of this letter.

Plan's Response:

The Plan states they implemented the changes as they were disclosed by PMPM in July immediately. Effective August 1, 2003, the general liability coverage has been increased to \$2 million, the coverage of the business assets is at \$275,000, and Mrs. Neshat's dental practice address has been eliminated from the policy.

The Plan is required to submit evidence that the changes described above have been made to the insurance policies. The plan should provide a copy of the amended insurance policies.

BOOKS AND RECORDS:

During the examination of books and records, a number of exceptions were noted that require immediate corrective action. In a number of cases, journal entries were required to correctly state the books and records of the Plan as of April 30, 2003. Following is a summary of the exceptions noted:

Cash in Bank:

- ☐ Checks written out of sequence (post dating and pre dating)
- ☐ No accountability or control over voided checks
- ☐ Inadequate internal control over cash and cash reconciliation activities
- ☐ A significant number of stale-dated checks remained on outstanding list

Premiums Receivable:

- ☐ General ledger control account and subsidiary ledger balances did not reconcile
- ☐ Receivable ledger includes amounts no longer considered collectible
- ☐ No provision has been made for uncollectible accounts
- ☐ Income tracked on two different computer systems; balances not reconciled on a monthly basis; variances noted

Prepaid Expenses:

- ☐ Unamortized portion of prepaid expenses were less than general ledger balance

Prepaid Supplies:

- ☐ Prepaid supplies were no longer on hand

Intangible Assets:

- ❑ Employer Group goodwill was overstated

Furniture, Fixtures, Equipment, Computer Hardware, Computer Software:

- ❑ Furniture & Fixtures general ledger balance was not supported by detail
- ❑ Physical inventory of assets indicates general ledger control account understated
- ❑ Accumulated depreciation of Computer Equipment understated

Capitation Payable:

- ❑ General ledger control account and subsidiary records not in balance

Incurred But Not Reported (IBNR) Claims Payable:

- ❑ General ledger account overstated based on detailed historical lag analysis

Trade Payables (Aggregate Write-Ins):

- ❑ General ledger control account and subsidiary records not in balance

Premium Income:

- ❑ Income tracked on two different computer systems; balances not reconciled on a monthly basis; variances noted

Professional Expense (FFS Claims):

- ❑ Expense overstated resulting from error in reversal of monthly IBNR accruals

Operating Expenses:

- ❑ Plan does not use journal vouchers; vendor files not well organized; difficult to trace paid invoices to supporting detail
- ❑ Too many expenses co-mingled into one expense account
- ❑ No clear policies governing ordering and purchase of supplies

***Recommendations:* The Plan shall work with its independent auditor and new CFO to resolve the above accounting issues as soon as possible and the Plan shall submit a detailed description of their resolution. As part of the re-construction process, the Plan shall submit documentation supporting that it has established written policies and procedures for the accounting department and also has re-evaluated its chart of accounts and made appropriate changes where needed.**

Plan's Response:

The Plan states its new Chief Financial Officer, Mr. Joseph Hughes is evaluating all areas of the accounting department and related functions therein in order to determine exactly what new controls and procedures need to be put into place.

Mr. Hughes has already implemented the following:

Cash in Bank:

All checks written will be reviewed upon completion and the numbers therein recorded in a disbursement log, also provisions have been made which will not allow for the (post dating and pre-dating) of any checks in the future. A voided check log and file have been established which requires the recording of all voided checks, the reason why and the actual retention of the voided checks themselves, which are kept in numerical sequence and by date of void. All cash reconciliation activities are being done strictly by the new CFO and his accounting assistant. All stale dated checks are being reviewed for current status and a final determination made on each item after appropriate review.

Premiums Receivable:

Corrective accounting measures have been undertaken in order to insure that the general ledger balances are reconciled on a weekly basis. Bad Debt provisions have been set as a percentage of total receivables and as certain accounts become uncollectible they will be charged and expensed to bad debt. Income tracking on two computer systems is necessary due to the-fact that one system is a proprietary medical software program and the other is a dedicated accounting system; however measures have been taken in order to insure that these two are reconciled on a monthly basis.

Prepaid Expenses:

Prepaid supplies have been inventoried and account for appropriately on the general ledger.

Intangible Assets:

Employer Group goodwill has computed in accordance with (GAAP) and restated on the balance sheet correctly.

Furniture, Fixtures, Equipment, Computer Hardware, Computer Software:

Furniture & Fixtures accounts on the general ledger has broken down by detail and recorded in the general ledger in accordance with (GAAP). Physical inventory of all assets has been retaken and restated on the general ledger in order to reflect the correct values. Accumulated depreciation of Computer Equipment has been recomputed in accordance with (GAAP) and restated on the general ledger.

Capitation Payable:

General ledger account and subsidiary accounts have been reconciled and balanced.

Incurred But Not Reported (IBNR) Claims Payable:

All claims are currently being reviewed in order to insure that they are not being recorded as payable until such time as they are actually approved for payment.

Trade Payables (Aggregate Write-Ins):

General ledger account and subsidiary records have been reconciled and adjustments made where appropriate.

Premium Income:

Income is racked and recorded on different computer systems, as this is absolutely necessary due to the-fact that one system is a proprietary medical software system and the other is a dedicated accounting

system; however every effort possible is being made to insure that the two are reconciled on a monthly basis.

Professional Expense: (FFS Claims):

The chart of accounts has been revised and additional general ledger accounts have been added which will correct this problem in the future.

Operating Expenses:

Plan vendor files have been reviewed and reorganized, which will now be easily accessible and each invoice can be reviewed for detail and payment state. Plan General ledger chart of accounts has and is being reviewed and where appropriate new general ledger accounts are being added which support itemized detail on payment of all expenses. Ordering of supplies has been addressed by implementing a requisition request, which will be reviewed and approved by the accounting department on an as-needed basis.

The Plan also states it is currently working with its outside independent auditor in order to address any additional issues, which could lead to additional changes being made or further accounting issues that may need to be addressed in the future.

The Plan is required to submit written policies and procedures that have been implemented in regards the Plan's accounting functions and changes as described in the response above.